

GEAR4MUSIC

CONSUMER DISCRETIONARY

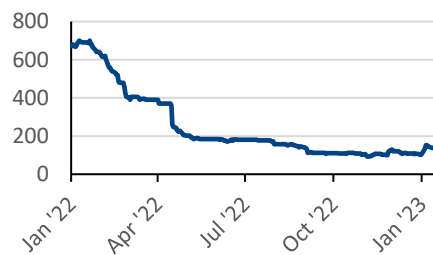
19 January 2023

G4M.L

139p

Market Cap: £29.1m

SHARE PRICE (p)



12m high/low

700p/93p

Source: LSE Data (priced as at prior close)

KEY DATA

Net (Debt)/Cash	£(21.8)m (at 30/09/22)
Enterprise value	£50.9m
Index/market	AIM
Next news	FY update, April '23
Shares in Issue (m)	21.0
Chairman	Ken Ford
Chief Executive	Andrew Wass
CFO	Chris Scott

COMPANY DESCRIPTION

Gear4music is a leading international online retailer of musical instruments and equipment.

www.gear4musicplc.com

GEAR4MUSIC IS A RESEARCH CLIENT OF
PROGRESSIVE

ANALYSTS

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Steady progress over peak trading period

G4M delivered a solid performance over its peak Q3 trading period, with financial performance in line with Board expectations. Group sales rose 5% over last year, with Europe performing particularly strongly (+11%). In the UK, sales were flat, with Royal Mail strikes and their knock-on impacts compounding the effects of weaker consumer sentiment. Lower marketing spend and labour efficiencies offset a temporarily softer gross margin, with G4M reiterating that FY23E EBITDA and net debt reduction are in line with consensus market expectations. Our forecasts therefore remain unchanged.

- Trading details – solid revenue delivery over peak period.** The strong trading momentum seen in H1 in Europe (+10%) has continued, nudging up to an 11% increase in Q3. This largely reflects the infrastructure investments of FY22, which saw the opening of two additional distribution hubs in Ireland and Spain. These openings served to improve the overall European customer and service propositions. The flat UK performance was stronger than in H1 (-3%), notwithstanding the disruption of the rolling Royal Mail strikes and their impact on the broader consumer delivery network. This resulted in longer delivery times, as well as necessitating an earlier-than-normal cut-off date for orders to guarantee delivery in time for Christmas.
- Operational performance – efficiencies offset softer gross margin.** As in H1, gross margin performance was softer than last year, but mitigated by tight control of the operating cost base. In Q3, the gross margin of 25.6% was 280bps lower than last year (28.4%), but only 70bps lower than the 26.3% achieved in H1 (and 60bps lower than the pre-Covid Q3 FY20 figure of 26.2%). The lower gross margin is viewed as temporary, reflecting a continuing targeted reduction both of on-hand inventory, as outlined in the interim results, and of net debt in a period of poorer consumer confidence. Firm control of labour and marketing costs has largely offset the impact of the softer gross margin.
- Outlook – macro challenges remain, forecasts unchanged.** G4M has performed robustly over its peak trading period, despite the challenges associated with the current macroeconomic backdrop and weaker levels of consumer confidence. While it remains difficult to envisage any significant easing of macroeconomic challenges and trading conditions over the short term, G4M has shown itself adept in managing its overall business performance. We therefore make no changes to our forecasts.

FYE MAR (£M)	2021	2022	2023E	2024E	2025E
Revenue	157.5	147.6	155.6	171.1	188.4
Adj EBITDA	19.8	11.2	8.9	11.9	14.6
Fully Adj PBT	14.6	5.0	1.1	3.3	5.4
Fully Adj EPS (p)	59.7	17.3	3.9	11.3	18.4
EV/Sales (x)	0.3x	0.3x	0.3x	0.3x	0.3x
EV/EBITDA (x)	2.6x	4.5x	5.7x	4.3x	3.5x
PER (x)	2.3x	8.0x	35.2x	12.3x	7.5x

Source: Company Information and Progressive Equity Research estimates.

This publication should not be seen as an inducement under MiFID II regulations.

Please refer to important disclosures at the end of the document.

Trading details

As we have done previously, we show G4M's revenue performance for both Q3 and the nine-month (9M) periods over previous years, back to FY20 as the pre-Covid base. The 9M revenue figures are calculated, being the sum of the H1 revenue figures and the Q3 trading update figures. We provide UK, International and total group figures, together with the gross margin percentage for the trading periods.

For the 9M period, the gross margin percentage figure has been calculated (by applying the Q3 gross margin figures provided by G4M in its trading updates to the Q3 revenue figures, calculating the Q3 gross profit and adding that to the H1 gross profit figures).

Q3 and 9M trading performance details – FY20 to FY23

Sales (£m)	Q3 FY23	Q3 FY22	Q3 FY21	Q3 FY20	9M FY23	9M FY22	9M FY21	9M FY20
UK	26.0	26.0	23.0	20.9	61.5	62.7	59.7	45.7
International	23.5	21.2	29.2	19.4	54.3	49.2	62.7	44.0
Total	49.5	47.2	52.2	40.3	115.8	111.9	122.4	89.7
Change on prior year period (%)	Q3	Q3	Q3	Q3	9M	9M	9M	9M
UK	0%	13%	10%	n.a.	-2%	5%	31%	n.a.
International	11%	-27%	51%	n.a.	10%	-22%	43%	n.a.
Total	5%	-10%	30%	n.a.	3%	-9%	36%	n.a.
Gross margin (%)	25.6%	28.4%	29.9%	26.2%	26.0%	28.2%	29.2%	25.6%

Source: G4M, Progressive Equity Research

The FY21 figures, for both sales and gross margin, reflect clearly how G4M benefitted from the pandemic, as described in previous company statements and [our notes](#), with FY20 representing a more steady-state, pre-Covid trading period. In that context, both the Q3 and 9M revenue figures are substantially ahead of the figures achieved in FY20. At the group level, 9M FY23 sales are some 29% higher than those delivered in the 9M FY20 period, within which the UK is some 35% higher, delivering three-year compound annual growth rates of 8.9% and 10.4%, respectively.

In terms of gross margin, the cumulative 9M FY23 performance is 40bps ahead of that achieved in FY20, despite Q3 FY23 being some 60bps lower. The lower gross margins have partly resulted from the decision in H1 to make targeted reductions in some slower-moving stock lines. Inventories decreased by £2.1m across the H1 period ending 30 September 2022 to £43.4m, though this level was some £5.9m (16%) higher than at the H1 period-end last year. Given this higher level of inventory, the usual increase in inventory in September to support the peak Christmas trading period was not required. G4M's stated intention was to see further inventory level reductions by the end of H2 FY23, with expectations of around £35.8m. Q3 has seen such a reduction, though not quantified, alongside the continuing planned reduction in net debt.

We leave our forecasts unchanged, with our key revenue, EBITDA and PBT figures for FY23E in line with consensus market expectations. The shape of delivering these profit figures will likely differ slightly from our full model, with a lower gross margin percentage delivering a lower gross profit figure, offset by lower operating costs.

Financial Summary: Gear4music

Year end: March (£m unless shown)

	2021	2022	2023E	2024E	2025E
PROFIT & LOSS					
Revenue	157.5	147.6	155.6	171.1	188.4
Adj EBITDA	19.8	11.2	8.9	11.9	14.6
Adj EBIT	15.5	6.1	2.8	4.9	7.0
Reported PBT	14.6	5.0	1.1	3.3	5.4
Fully Adj PBT	14.6	5.0	1.1	3.3	5.4
NOPAT	13.4	4.6	2.1	3.6	5.2
Reported EPS (p)	59.7	17.3	3.9	11.3	18.4
Fully Adj EPS (p)	59.7	17.3	3.9	11.3	18.4
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
CASH FLOW & BALANCE SHEET					
Operating cash flow	15.0	(4.1)	16.6	11.7	15.8
Free Cash flow	9.8	(14.1)	7.8	2.4	6.4
FCF per share (p)	46.8	(67.2)	37.2	11.2	30.5
Acquisitions	(0.2)	(10.4)	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	0.0	0.0	0.0	0.0
Net cash flow	8.3	(26.9)	6.3	0.8	4.9
Overdrafts / borrowings	(3.5)	(28.0)	(24.5)	(21.0)	(20.5)
Cash & equivalents	6.2	3.9	6.7	4.0	8.4
Net (Debt)/Cash	2.7	(24.2)	(17.9)	(17.0)	(12.1)
NAV AND RETURNS					
Net asset value	34.3	38.0	37.4	38.3	40.7
NAV/share (p)	163.8	181.5	178.2	182.6	194.3
Net Tangible Asset Value	23.9	18.2	15.7	15.2	16.9
NTAV/share (p)	114.2	87.0	74.8	72.7	80.4
Average equity	28.0	36.2	38.5	40.1	43.3
Post-tax ROE (%)	17.9%	3.2%	8.6%	13.4%	0.0%
METRICS					
Revenue growth		(6.2%)	5.4%	9.9%	10.1%
Adj EBITDA growth		(43.3%)	(20.2%)	32.6%	23.4%
Adj EBIT growth		(60.3%)	(54.6%)	77.1%	42.4%
Adj PBT growth		(65.8%)	(77.2%)	187.2%	63.4%
Adj EPS growth		(71.1%)	(77.3%)	187.2%	63.4%
Dividend growth		N/A	N/A	N/A	N/A
Adj EBIT margins		4.2%	1.8%	2.9%	3.7%
VALUATION					
EV/Sales (x)	0.3	0.3	0.3	0.3	0.3
EV/EBITDA (x)	2.6	4.5	5.7	4.3	3.5
EV/NOPAT (x)	3.8	11.2	24.7	14.0	9.8
PER (x)	2.3	8.0	35.2	12.3	7.5
Dividend yield	N/A	N/A	N/A	N/A	N/A
FCF yield	33.8%	(48.5%)	26.8%	8.1%	22.0%

Source: Company information and Progressive Equity Research estimates

Disclaimers and Disclosures

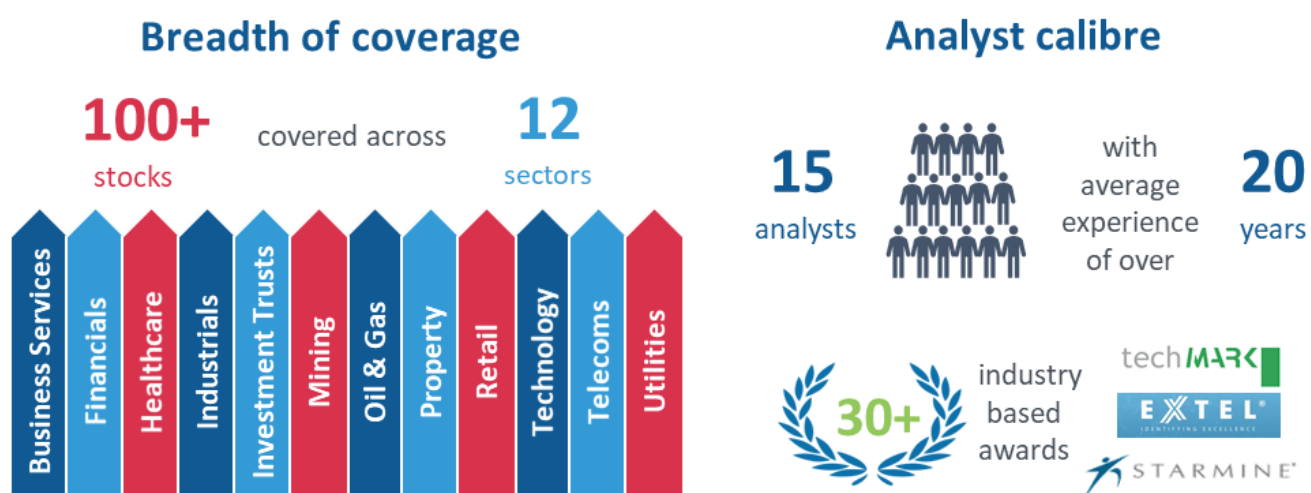
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